80-1364

No. .....

Office Supreme Court, U.S.
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In The
Supreme Court of the United States
October Term, 1980

JAMES ISKE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

JAMES ISKE
Box 610
Bellevue, Nebraska 68005
Telephone: (402) 291-3030
Pro Se

COCKLE PRINTING CO., 2311 Douglas St., Omaha 68102

QUESTIONS PRESENTED FOR REVIEW

1. Is the taxpayer-appellant entitled to have gain from the condemnation of easements that occurred in August of 1967 determined using a basis computed under the principle set out in I. T. 2621, XI-1 Cumulative Bulletin 67 (1932)?
2. Whether the Court of Appeals was in error in affirming the Trial Court's misapplication of the rule that income is taxed in accordance with the method of accounting used by the taxpayer (cash basis) when it taxed $25,000.00 received in 1968 from a condemnation as income in 1970?
3. Whether the Court of Appeals was in error in affirming the Trial Court's misapplication of the rules that legal, etc., expenses incurred to increase the amount received on the disposition of property is part of the basis of the property disposed of when part of the expenses are attributable to the collection of interest income derived from the disposition of the property?
4. Whether the Court of Appeals was in error in affirming the Trial Court's misapplication of the rule that interest income derived from a municipal governmental agency is exempt from Federal income tax?
5. Whether the Court of Appeals was in error in affirming the Trial Court's misapplication of the rule that income derived from the sale of sand, gravel and rock is not capital gain income?
6. Whether the Court of Appeals was in error on August 22, 1980 in denying the appellant's motion for a stay of judgment?
7. Whether the burden of proof imposed on appellant constitutes a denial of due process to the appellant?

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JAMES ISKE,

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COMMISSIONER OF INTERNAL REVENUE,

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On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioner respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the Tax Court was reported at T. C. memo 1980-61. The opinion of the Eighth Circuit Court of Appeals was designated for nonpublication. Both opinions are reproduced in the Appendix, infra A1 and A20 respectively.

JURISDICTION

The Appeals Court entered judgment on November 18, 1980.

This Court has jurisdiction under 28 U. S. C. Section 1254 (1).

THE STATUTES INVOLVED

Section 451 (a) of the 1954 Internal Revenue Code—

> (a) General Rule—The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 103 (a) of the 1954 Internal Revenue Code—

> (a) General Rule—Gross income does not include interest on—
>
> (1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia; and
>
> (2) qualified scholarship funding bonds.

Sections 103 (b) (1) and (b) (6) of the 1954 Internal Revenue Code—

(b) Industrial Development Bonds—

(1) Subsection (a) (1) or (2) Not to Apply—Except as otherwise provided in this subsection, any industrial development bond shall be treated as an obligation not described in subsection (a) (1) or (2).

(6) Exemption for Certain Small Issues—

(A) In General—Paragraph (1) shall not apply to any obligation issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less and substantially all of the proceeds of which are to be used (i) for the acquisition, construction, reconstruction or improvement of land or property of a character subject to the allowance for depreciation, or (ii) to redeem part or all of a prior issue which was issued for purposes described in clause (i) or this clause.

STATEMENT OF THE CASE

1. Discrimination

Petitioner, James Iske, filed a petition in the Tax Court on May 3, 1977 seeking to reduce assessments for additional income taxes for the calendar years 1970, 1971 and 1972 based on a number of different reasons.

Taxpayer relied on *I. T. 2121 XI-1 Cumulative Bulletin 67 (1932)* in computing his basis in land in determining gain from the taking of a right-of-way easement in August of 1967 through an eminent domain proceeding.

Taxpayer received $25,000.00 in May of 1968 from the condemnation with the remainder of the award being paid in 1970 and 1971 after litigation in the Nebraska Courts as to the amount of the award. *I. T. 2121,* supra, was a Revenue Ruling published in 1932 and kept on the books until it was declared obsolete by Revenue Ruling 68-661 1968-2 Cumulative Bulletin 607 (1968) with the instruction that it would not be determinative with respect to future transactions. Many taxpayers have relied on I. T. 2121, supra, for over 36 years. Taxpayer's land was condemned and some money was received prior to the time Revenue Ruling 68-661 caused I. T. 2121 to be declared obsolete with respect to future transactions. *International Business Machines Corporation v. U. S.,* 343 F. 2d 914, Court of Claims Certiorari denied 382 U. S. 1028; Amendment Article V of the Constitution.

2. Method of Accounting

Taxpayer, an individual farmer, uses the cash basis method of accounting in determining his taxable income for purposes of the Federal income tax. This fact was totally ignored by the Trial Court when it ruled that $25,000.00 received in 1968 from the 1967 condemnation proceeding was taxable in 1970 when the remaining amount of the award was received. Section 451 (a) of the Internal Revenue Code of 1954.

3. Expense Incurred to Collect Interest Income

Taxpayer paid substantial legal and other expenses in relation to the condemnation proceedings. As a result, taxpayer received a condemnation award plus interest. The Trial Court in its findings determined that the interest in-

come element portion of the award was not eligible for capital gain treatment but instead considered the interest as ordinary income. However, the Trial Court ruled all of the legal, etc., costs should be attributed to the capital gain portion of the award with the result no portion of the legal costs were considered as ordinary expenses incurred to offset the interest income collected on the award. The delay in collection which resulted in the interest income is attributable to the litigation in the Nebraska Courts. Section 1:212 (k) income tax regulations.

4. Tax Exempt Interest

Taxpayer received interest of $20,268.49 in 1970 and $8,716.00 in 1971 from Omaha Public Power District, a governmental agency in Nebraska for the purpose of furnishing electricity.

5. Sand and Gravel, Etc.

Taxpayer received the following amounts from the sale of sand, gravel, rock, etc.:

1970	$ 4,346.92
1971	3,450.00
1972	18,982.86

Taxpayer is principally a farmer but his land has sand, gravel and rock deposits. Some of this was extracted and sold in 1970, 1971 and 1972. The remaining land has been depleted by such sales since the extraction has removed a portion of the land forever. *Rabiner v. Bacon*, 373 F. 2d 538 (Eighth Circuit 1957).

6. Denial of Stay of Judgment

The Eighth Circuit Court of Appeals denied on August 22, 1980, appellant's stay of judgment. This denial amounts to a denial of due process to the appellant under Amendment Article V of the Constitution.

7. Burden of Proof

The imposition of the burden of proof on appellant in income tax matters constitutes a denial of due process to the appellant under Amendment Article V of the Constitution.

———o———

REASONS RELIED UPON FOR ALLOWANCE OF WRIT

Discrimination

The Trial Court's refusal to allow taxpayer to follow *I. T. 2121,* supra, which was upheld by the Court of Appeals results in taxpayer being discriminated against in view of the many taxpayers who since 1932 have been allowed to the ruling. This constitutes a denial of due process.

Method of Accounting

The Trial Court acknowledged the receipt by the taxpayer of $25,000.00 in 1968 but never addressed the defense that this $25,000.00 should have been income in 1968. The Court of Appeals did not discuss the Trial Court's clear error of law as not following the taxpayer's method

of accounting and requiring the $25,000.00 be reported in 1968.

Expenses Incurred to Collect Ordinary Income

The Court of Appeals did not discuss the Trial Court's clear error of law in not attributing part of the legal expenses to the collection of interest income as ordinary deductions. The Court of Appeals neglected its judicial function in failing to give due consideration in this error in the Trial Court's decision.

Tax Exempt Interest Income

The treatment of interest income as tax exempt under Section 103 is an area this Court has not reviewed in the light Section 103 (b) (6) which shows Congressional intent to expand the concept of tax exempt interest income even to the extent where the borrowed money is for the specific benefit of private individuals.

Sand, Gravel and Rock

The Trial Court's error in denying capital gain treatment to income from the sale of sand, gravel, rock, etc., denies the taxpayer of his property. In view the Court of Appeals did not discuss this error, it has neglected its judicial function in failing to give due consideration to this error.

Stay of Judgment

Eighth Circuit's denial, on August 22, 1980, of appellant's motion for stay of judgment is an error which denies due process to appellant.

Burden of Proof

Imposition of burden of proof on appellant on income tax matters is an error which denies due process to appellant.

CONCLUSION

The petitioner, James Iske, respectfully prays that a Writ of Certiorari be issued to review the judgment and opinion of the United States Circuit Court of Appeals for the Eighth Circuit entered on November 18, 1980.

Respectfully submitted,

JAMES ISKE

Box 610
Bellevue, Nebraska 68005
Telephone: (402) 291-3030

Pro Se

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

T. C. Memo 1980-61

UNITED STATES TAX COURT

JAMES ISKE, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 4311-77. Filed March 5, 1980.

James Iske, pro se.

J. Anthony Hoefer, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

HALL, *Judge*: Respondent determined the following deficiencies in petitioner's income tax:

Year	Deficiency
1970	$8,753.83
1971	4,037.14
1972	1,250.91

Due to concessions by petitioner, the issues remaining for decision are:

1. Whether petitioner realized taxable gain in 1970 or 1971 from the grant of easements pursuant to condemnation proceedings.

2. Whether unreimbursed legal, appraisal or witness fees incurred by petitioner in connection with the condemnation of easements across his land are deductible in 1970 and 1971 as ordinary and necessary business expenses.

3. Whether interest income received by petitioner in 1970 and 1971 as part of condemnation awards is tax exempt.

4. Whether petitioner's sales of dirt, sand and gravel in 1970, 1971 and 1972 generated ordinary income or capital gains.

5. Whether petitioner is entitled to percentage depletion for 1970, 1971 and 1972 in excess of amounts allowed by respondent.

6. Whether petitioner is entitled to depreciation deductions as claimed on his 1970, 1971 and 1972 income tax returns.

7. Whether petitioner is entitled to business expense deductions for 1971 and 1972 in excess of amounts allowed by respondent.

FINDINGS OF FACT

All of the facts have been stipulated and are found accordingly.

At the time of filing his petition, James Iske was a resident of Omaha, Nebraska.

Condemnation Awards

On August 9, 1967, the Omaha Public Power District ("OPPD")[1] instituted eminent domain proceedings in the County Court of Sarpy County, Nebraska. OPPD sought to acquire a right-of-way easement across land owned by petitioner in Sarpy County. The easement was sought

1 Omaha Public Power District, a public corporation, is a public power district engaged in the light and power business within the meaning of Neb. Rev. Stat. sec. 70-601 et seq.

for the purpose of constructing, operating and maintaining electrical transmission lines. The Sarpy County Court granted OPPD the easement and awarded petitioner $94,870 in damages. This amount was deposited with the court on September 13, 1967. On May 17, 1968, $25,000 of the award was released to petitioner by the court.

On October 16, 1967, petitioner appealed the Sarpy County Court decision to the District Court of Sarpy County. The District Court judgment held that OPPD was liable to petitioner as follows (plus interest until paid):

Damages to land by the easement condemned	$135,000
Attorney's fees	13,500
Expert witness fees	1,500 [2]
Total	$150,000

The District Court judgment was affirmed by the Nebraska Supreme Court on July 20, 1970.[3] On August 14, 1970, petitioner received a check for $145,268.49 in full satisfaction of the District Court's judgment of $150,000 plus interest of $20,268.49 to August 13, 1970, taking into consideration the $25,000 previously released to petitioner.

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2 Petitioner incurred an additional $35,000 in unreimbursed legal, appraisal and witness fees.

3 *Iske v. Omaha Public Power District*, 185 Neb. 724, 178 N. W. 2d 633 (1970).

Petitioner's land is Sarpy County from which OPPD's easement was taken included the following:

> The Southeast Quarter (SE ¼) of the Southeast Quarter (SE ¼) of Section Twenty (20) and the East One-half (E ½) of the Northeast Quarter (NE ¼); Tax Lots 6A, 6C and 6C1 of Section Twenty-nine (29), Township thirteen (13) North, Range thirteen (13) east of the 6th P.M., in Sarpy County, Nebraska.

The easement area condemned was 38.3 acres described as follows:

> A strip of land 400 feet in width, 325 feet East of and parallel to and 75 feet West of and parallel to the following described reference line: Beginning at a point on the South line of said Section twenty-nine (29), 975 feet West of the Southeast corner thereof; thence in a Northwesterly direction to a point of turning located 1,227 feet West of and 4,420 feet South of the Northeast corner thereof, also—
>
> A strip of land 300 feet in width, 225 feet East of and parallel to and 75 feet West of and parallel to the following described reference line: Beginning at the above stated point of turning and continuing in a Northerly direction to a point of turning located 1,252 feet West of and 753 feet South of the aforesaid Northeast corner; thence in a Northwesterly direction to a point of leaving located on the North line of the South One-half (S½) of the Southeast Quarter (SE ¼) of said Section twenty (20), 1,363 feet West of the Northeast corner thereof.

On August 10, 1967, OPPD instituted a second eminent domain proceeding in the County Court of Cass County to acquire a right-of-way easement across land owned by petitioner in Cass County. Again, OPPD

wished to acquire the easement for the purpose of constructing, operating and maintaining electrical transmission lines. The Cass County Court awarded petitioner $35,000 damages plus interest of $8,716. The award was paid in 1971. Petitioner incurred $15,128.85 of unreimbursed legal, appraisal and witness expenses in connection with this eminent domain proceeding.

Petitioner's land in Cass County from which OPPD's easement was taken is described as follows:

> The Northeast Quarter (NE ¼) of the Northeast Quarter (NE ¼) of Section Thirty-two (32), Township thirteen (13) North, Range, thirteen (13) east of the 6th P.M., in Cass County, Nebraska.

The specific easement that OPPD acquired from petitioner during this proceeding is described as follows:

> A strip of land 400 feet in width, 325 feet East of and parallel to and 75 feet West of and parallel to the following described reference line: Beginning at a point 365 feet West of the East line of said Section thirty-two (32) and 3,260 feet North of the South line thereof, thence in a Northwesterly direction to a point of leaving located on the North line thereof, 975 feet West of the Northeast corner thereof.

On his 1970 return, petitioner reported the $20,268.49 interest income received as part of the Sarpy County easement award. On his 1971 return, petitioner reported the $8,716 interest income received as part of the Cass County easement award. Petitioner did not recognize any capital gain income in either 1970 or 1971 from the transfers of the easements to OPPD.

In his statutory notice, respondent determined that petitioner realized the following long term capital gain in 1970 on the transfer of the Sarpy County land to OPPD:

Award for land		$135,000
Less: Basis (38.3 acres at $191)	$ 7,315	
Unreimbursed expenses [4]	35,000	(42,315)
Long term capital gain		$ 92,685

Respondent determined that petitioner realized the following long term capital gain in 1971 on the transfer of the Cass County land to OPPD:

Award for land		$35,000.00
Less: Basis	$ 600.00	
Unreimbursed legal, witness and appraisal expenses	15,128.85[5]	(15,728.85)
Long term capital gain		$19,271.15

No part of the awards were for severance damages.

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4 Respondent calculated unreimbursed expenses as follows:

Legal, appraisal and witness fees paid by petitioner	$50,000
Less: Fees awarded by court	(15,000)
Unreimbursed expense	$35,000

5 Petition claimed $1,291 of this amount as a business expense in 1971. Respondent disallowed this deduction, but included the $1,291 in the $15,128.85 used above to reduce the amount of the condemnation award.

Sales of Dirt, Sand and Gravel

On March 24, 1970, petitioner entered into a contract to sell dirt, sand and gravel to Hartford Sand and Gravel Co. ("Hartford"). Pursuant to this contract, petitioner agreed to sell Hartford a specified amount of dirt, sand and gravel from a portion of his Sarpy County land. Pertinent parts of the contract provided:

> 4. Seller hereby grants to Buyer the option to buy during 1970 and the first five months of 1971 as much as, but not more than 100,000 tons of sand and gravel at a price of eight cents per ton. Fully warranted title to such sand and gravel material shall be deemed to pass to Buyer upon removal of the material from the above-described real estate.
>
> • • •
>
> 7. Buyer shall have no right to sell, remove or cause to be removed any dirt or waste sand from the premises, except that Buyer may purchase as much as, but not more than 100,000 tons of dirt or waste sand at five cents per ton.
>
> • • •
>
> 19. This agreement for the purchase of dirt, sand, gravel and sand and gravel, if not terminated earlier, shall terminate on June 1, 1971. After termination, Buyer shall have an additional period of six months during which Buyer may complete the purchase of materials already processed, but remaining on the premises, on the same terms as hereinabove specified, provided that in no event shall the total number of tons of material removed exceed the amounts specified in paragraphs 4 and 7 above. Buyer or its successors may also, during said six month period, and so long as not in default as to payments due under this contract, remove any and all equipment, including both temporary and permanent structures, from the above premises. After December 1, 1971, all

ownership in equipment, structures and material, both processed and unprocessed remaining on the premises described above, shall be considered as abandoned to the Seller by the Buyer and its successors, and rights conferred on Buyer or its successors under this Contract of Sale shall be considered as terminated.

The contract did not require Hartford to extract a minimum amount of minerals. The following table reflects the amount of dirt, sand and gravel income reported by petitioner as ordinary income and the amount actually received for material sold to Hartford during the years in issue:

Year	Amount Reported	Actual Sales
1970	$ 3,747.00	$ 4,346.92
1971	3,769.00	3,450.00
1972	19,309.00	18,982.86

Petitioner did not claim any depletion deductions with respect to his sales of minerals during the years in issue. Respondent determined that petitioner was entitled to depletion deductions in connection with these sale of $217.35 for 1970, $172.50 for 1971 and $932.65 for 1972.

Depreciation Deductions

The following tables reflect the amount of depreciation claimed by petitioner for 1970, 1971 and 1972, the amount allowed by respondent and the resulting adjustments proposed by respondent:

1970

Item	Amount Claimed	Allowed	Proposed Adjustment
Farm, buildings and equipment	$2,294.00	$ —0—	$2,294.00
Truck	500.00	500.00	—0—
Two Houses	700.00	—0—	700.00
Total	$3,494.00	$500.00	$2,994.00

1971

Item	Amount Claimed	Allowed	Proposed Adjustment
Farm, buildings and equipment	$3,010.00	$ —0—	$3,010.00
Truck	500.00	500.00	—0—
Car	460.00	—0—	460.00
Calculator	—0—	35.10	(35.10)
Total	$3,970.00	$535.10	$3,434.90

1972

Item	Amount Claimed	Allowed	Proposed Adjustment
Farm, buildings and equipment	$3,010.00	$ —0—	$3,010.00
Truck	500.00	—0—	500.00
Car	460.00	—0—	460.00
Calculator	—0—	35.10	(35.10)
Total	$3,970.00	$ 35.10	$3,934.90

Business Expenses

In 1971 petitioner claimed the $351 cost of a calculator as a business expense. Respondent determined that the calculator was a capital asset and, in his notice of deficiency, disallowed the $351 business expense deduction.[6]

The following table reflects Sechedule F business expenses claimed by petitioner for 1972 and the amount allowed by respondent:

Item	Amount Claimed	Amount Allowed
Labor and repairs	$ 1,005.00	$ 1,195.50
Feed	416.00	416.00
Seed	573.00	460.00
Fertilizer	1,603.00	1,839.52
Machine hire	581.00	178.00
Supplies	1,597.00	731.86
Veterinary	63.00	592.72
Gasoline	483.00	114.44
Storage	638.00	678.93
Taxes	5,568.00	5,321.39
Insurance	143.00	186.20
Utilities	597.00	299.44
Freight, travel, management	2,197.00	1,756.00
Total	$15,435.00[7]	$13,770.00

Respondent disallowed $1,665 ($15,435 minus $13,770) of the amount claimed.

6 Respondent allowed petitioner to deduct depreciation expense of $35.10 per year in 1971 and 1972.

7 The correct total is $15,464.

OPINION

Condemnation Awards

The first issue is whether petitioner realized taxable gain in 1970 and 1971 from the grant of easements across his Sarpy County and Cass County land. More specifically, the issue is whether petitioner's basis for determining gain on the condemnation sales of easements in 1970 and 1971 should include his basis for the property beyond the immediate area to which the easements apply. Petitioner contends that the basis used in computing his 1970 and 1971 gains should reflect his entire interest in Sarpy and Cass County land from which the easements were taken. On the other hand, respondent contends that in determining petitioner's gain on the sale of the easements, only petitioner's basis allocable to the immediate acreage covered by the easements may be utilized. We agree with respondent.

Petitioner relies on I. T. 2621, XI-I C. B. 67, promulgated in 1932, wherein a taxpayer sold an easement across 160 acres of land for the construction, maintenance, operation and repair of power transmission lines while reserving for himself the right to use the land for cultivation. On these facts, respondent ruled that in determining gain or loss the amount received for the sale of the easement should be applied against the cost of the total tract of land from which the easement was carved. On December 23, 1968, respondent declared I. T. 2621 obsolete. Rev. Rul. 68-661, 1968-2 C. B. 607.[8] Nonetheless, petitioner argues that I. T. 2621 is dispositive of his case because the

8 See also Rev. Rul. 59-121, 1959-1 C. B. 212, clarified by Rev. Rul. 68-291, 1968-1 C. B. 351.

condemnation proceedings were instituted before issuance of Revenue Ruling 68-661.

While often helpful in interpreting a statute, a revenue ruling is not binding on the Secretary or the courts; a ruling does not have the effect of a regulation or a Treasury Decision. *Stubbs, Overbeck & Associates v. United States*, 445 F. 2d 1142, 1146-1147 (5th Cir. 1971); *Browne v. Commissioner*, 73 T. C. No. 56 (Jan. 22, 1980), concurring opinion. Since at least 1945, it has been this Court's position that in computing gain or loss from the disposition of part of an interest in property, a taxpayer must utilize only his basis allocable to that portion, except when apportionment of basis is impossible or impractical. *Blum v. Commissioner*, 5 T. C. 702, 709 (1945). In 1947 we applied this principle to the determination of the gain or loss realized upon the condemnation of an easement. See *Inaja Land Co., Ltd. v. Commissioner*, 9 T. C. 727 (1947). We have recently reaffirmed our position in *Fasken v. Commissioner*, 71 T. C. 650 (1979), which involved the 1974 grant of four easements across a ranch. In holding that the gain realized should be computed by applying the consideration the taxpayers' received against that portion of their adjusted basis for the ranch which was allocable to the acreage covered by the easements, we relied primarily on section 1.61-6 (a), Income Tax Regulations[9] and *Inaja Land Co., Ltd. v. Commissioner, supra.*

Section 1.61-6 (a) provides in part that:

> When a part of a larger property is sold, the cost or other basis of the entire property shall be equitably apportioned among the several parts, and the gain

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9 All statutory references are to the Internal Revenue Code of 1954, as in effect during the years in issue.

> realized or loss sustained on the part of the entire property sold is the difference between the selling price and the cost or other basis allocated to such part. The sale of each part is treated as a separate transaction and gain or loss shall be computed separately on each part. Thus, gain or loss shall be determined at the time of sale of each part and not deferred until the entire property has been disposed of.

Thus, in order to compute the gain or loss from disposition where property is acquired for a lump sum and a portion of that property is disposed of separately, an allocation of the cost or other basis to the several parts must be made. Only if an apportionment of the basis is impossible or impractical may the selling price be credited against the basis for the entire property. *Inaja Land Co., Ltd. v. Commissioner, supra.* Otherwise, the gain or loss realized is the difference between the selling price of the portion of the property sold and the cost or other basis allocated to that part. *Inaja Land Co., Ltd. v. Commissioner, supra; Blum v. Commissioner, supra.*[10]

The basis of the property and whether an allocation of that basis to the property affected by the easement cannot be made are issues of fact on which petitioner has the burden of proof. Rule 142 (a), Tax Court Rules of Practice and Procedure; *Fasken v. Commissioner, supra.* Peti-

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10 In support of his argument that the consideration received on the sale of his easements should be credited against the basis for his entire property, petitioner also cites *Conway v. United States,* an unreported case (W. D. Ky. 1973, 31 AFTR 2d 73-1028, 73-1029, 73-1 USTC par. 9318) and *Bledsoe v. United States,* an unreported case (N. D. Okla. 1967, 20 AFTR 2d 5282, 5283, 67-2 USTC par. 9581). We have previously declined to follow the District Courts' holdings in *Conway* and *Bledsoe* and continue to do so here for the reasons mentioned in *Fasken v. Commissioner,* 71 T. C. 650, 657, n. 4 (1979).

tioner contends that he received the land, from which the easements were taken, by inheritance from his parents. He further contends that the fair market value of this property on the date of his parents' respective deaths was $161,285.95. Petitioner argues that $161,285.95 is his basis in the land in issue and that the full $161,285.95 should be used to compute the gain or loss realized on the condemnations.

Although petitioner submitted copies of his parents' estate tax returns, Forms 706, showing he was the beneficiary of various real estate interests in Sarpy County, petitioner did not explain how he derived the alleged $161,285.95 basis for the specific property interests from which the Sarpy County and Cass County easements were taken. It is not even clear whether petitioner received by devise the property interests from which the easements were taken. The property descriptions on the estate tax returns differ from those cited in the condemnation proceedings. Moreover, petitioner did not present any evidence showing that a portion of his basis could not be allocated to the property affected by the easement. Accordingly, we sustain respondent's determination.

The next issue is whether the unreimbursed legal, appraisal or witness fees incurred by petitioner in 1970 and 1971 in connection with the condemnation proceedings are deductible as ordinary and necessary business expenses under section 162. Respondent allowed petitioner to capitalize these expenses in computing petitioner's gains from the Sarpy County and Cass County condemnation awards. Petitioner, however, contends that the fees represent ordinary and necessary business expenses deductible under section 212.

When legal and related expenses incurred in connection with condemnation proceedings are incurred for the purpose of increasing the taxpayer's award for the loss of his property, the expenses are capital expenditures. *Soelling v. Commissioner,* 70 T. C. 1052, 1055 (1978); *Casalina Corp. v. Commissioner,* 60 T. C. 694, 703 (1973), affd. 511 F. 2d 1162 (4th Cir. 1975). Here, petitioner incurred the expenses in his attempt to increase the award for the property; therefore, we hold for respondent on this issue.

The next issue for decision is whether interest income received in 1970 and 1971 as part of the condemnation awards is tax exempt under section 103. Petitioner previously reported interest income of $20,268.49 and $8,716 received respectively in 1970 and 1971 in connection with his condemnation awards. Petitioner now contends that this interest is exempt income under section 103.

Generally, section 103 (a) excludes from gross income interest received on obligations of any state, territory or possession of the United States, or any political subdivision of the foregoing. This exemption applies only to interest on certain governmental "obligations." However, interest received as part of a condemnation award is not interest on an obligation within the meaning of section 103 (a). *Williams Land Co. v. United States,* 90 Ct. Cl. 499, 31 F. Supp. 154 (1940). Accordingly, petitioner is not entitled to exempt the interest received from his gross income.

Petitioner alternatively argues that since the interest was received in conjunction with the condemnation award, it should be given capital gain treatment. However, where money is paid as indemnification for delay in payment of

a condemnation award after property has already been condemned it is taxable as ordinary income. See *Kieselbach v. Commissioner,* 317 U. S. 399 (1943). Petitioner has not presented any evidence demonstrating that the sums in issue were other than compensation for delay in payment of the condemnation awards. Accordingly, we hold that petitioner must include the $20,268.49 and $8,716 interest received in 1970 and 1971 as ordinary income.

Sales of Dirt, Sand and Gravel

On March 24, 1970, petitioner contracted to sell dirt, sand and gravel from a portion of his Sarpy County property to Hartford Sand and Gravel Co. ("Hartford"). Under this contract Hartford had the option to buy as much as (but not more than 100,000 tons of sand and gravel at eight cents per ton and as much as (but not more than) 100,000 tons of dirt at five cents per ton. The contract expired on June 1, 1971, if not terminated earlier. After termination Hartford had an option for six months to complete the purchase of sand and gravel already processed but remaining on the premises. Petitioner received payments for materials sold to Hartford under this contract of $4,346.92 in 1970, $3,450 in 1971 and $18,982.86 in 1972. Petitioner contends that these sales generated income taxable as long term capital gains. On the other hand, respondent contends that petitioner retained an economic interest in the property and thus the sale of minerals generated ordinary income. We agree with respondent.

Whether a taxpayer must report income from the sale of sand and gravel as ordinary income or capital gain depends on whether or not he has retained an economic interest in the minerals in place. *Oliver v. United States,* 408

F. 2d 769, 771 (4th Cir. 1969). If the taxpayer retains an economic interest, he must report his sales income as ordinary income, but is entitled to a deduction for depletion. Sec. 611; *Oliver v. United States, supra.* The test in determining whether a taxpayer possesses an economic interest is (1) whether the taxpayer has acquired by investment an interest in the minerals in place and (2) whether he looks to the income from the extraction of the materials for a return of his investment. Sec. 1.611-1 (b) (1), Income Tax Regs.; *Palmer v. Bender,* 287 U. S. 551, 557 (1933); *Weaver v. Commissioner,* 72 T. C. 594 (1979).

Here, petitioner was clearly dependent on extraction for a return of his capital. He received payment only when Hartford removed dirt, sand and gravel from his land. The agreement provided for petitioner to receive 8 cents per ton of sand and gravel removed and 5 cents per ton of dirt removed. The only interest petitioner transferred was the right to extract and remove a limited quantity of dirt, sand and gravel for a limited period of time. See *Rabiner v. Bacon,* 373 F. 2d 537 (8th Cir. 1967). No minimum extraction was required. See *Lesher v. Commissioner,* 73 T. C. No. 32 (Nov. 27, 1979). In light of these facts, we conclude that petitioner did not divest himself of his economic interest in the minerals in place. Accordingly, the sale proceeds received by petitioner are ordinary income subject to a depletion allowance.

Section 613 (b) (6) allows a depletion deduction equal to five percent of the gross income from sales of sand and gravel. Section 613 (b) (7) allows a 14 percent depletion for sales of limestone under certain circumstances.

Respondent allowed petitioner a depletion deduction for each of the years in issue equal to five percent of petitioner's sales of sand, gravel and rock. Petitioner contends that he is entitled to a greater depletion deduction than that allowed by respondent because part of his sales were limestone. However, petitioner did not present any evidence showing he made sales of limestone or that such sales were made under circumstances that would entitle petitioner to the 14 percent allowance under section 613 (b) (7).[11] Accordingly, we sustain respondent's determination.

Depreciation Deductions

Respondent determined that petitioner was not entitled to section 167 depreciation deductions of $2,994 claimed by petitioner in 1970, $3,434.90 claimed in 1971 and $3,934.90 claimed in 1972. Petitioner presented no evidence as to his basis in the assets for which he claimed depreciation, their useful life, when the items were put into service or the amount of depreciation allowed or allowable in prior years. Accordingly, petitioner has failed to carry his burden of proof, Rule 142 (a), Tax Court Rules of Practice and Procedure, and his claimed depreciation deductions in excess of the amount previously allowed by respondent are denied.

Business Expenses

Petitioner claimed the $351 cost of a calculator purchased in 1971 as a section 162 business expense deduction.

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11 Petitioner also did not present evidence which would allow us to hold that he was entitled to cost depletion if it were greater than percentage depletion. See sec. 613 (a).

Respondent denied the deduction based upon his determination that the calculator was a depreciable asset having a ten-year useful life.[12] Petitioner did not present any evidence showing that the cost of the calculator was other than a capital expenditure. Accordingly, we sustain respondent's determination.

Respondent also determined that petitioner was not entitled to Schedule F business expenses of $1,665 claimed in 1972. Petitioner presented no evidence as to these claimed deductions. Since petitioner has failed to carry his burden of proof, Rule 142 (a), Tax Court Rules of Practice and Procedure, his claimed deductions in excess of the amount previously allowed by respondent are denied.

Decision will be entered
for the respondent.

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12 Respondent allowed petitioner section 167 depreciation deductions for 1971 and 1972 with respect to this asset.

UNITED STATES COURT OF APPEALS
For the Eighth Circuit

No. 80-1448

JAMES ISKE,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee,

Appeal from the Decision of the United States Tax Court

Filed: November 18, 1980

Before LAY, Chief Judge, GIBSON, Senior Circuit Judge, and HEANEY, Circuit Judge.

ORDER

Appellant James Iske appeals from the Tax Court determination that he was responsible for federal income tax deficiencies totaling over $14,000 for the years 1970-1972.[1] Specifically, the appellant challenges the findings of the Tax Court concerning the following issues:

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1 *Iske v. Commissioner,* 80 T. C. M. (P-H) ¶ 80,061 at 335 (1980).

(1) Whether the appellant realized taxable gain in 1970 and 1971 from the grant of easements pursuant to condemnation proceedings. The primary question is whether the basis to determine gain from an easement award should include the appellant's basis for property beyond the immediate area to which the easement applies.

(2) Whether the interest income received by the appellant in connection with the condemnation of an easement across his land is exempt from federal income tax.

(3) Whether certain legal, appraisal or witness fees incurred by the appellant in connection with the condemnation proceedings are deductible as ordinary and business expenses.

(4) Whether the appellant's sales of rock, sand and gravel or soil generated ordinary income or capital gains.

(5) Whether the appellant is entitled to depreciation deductions in excess of the amount allowed by the appellee.

(6) Whether the appellant is entitled to business expense deduction in excess of amounts allowed by the appellee.

We have carefully reviewed the record and the briefs in this case and are convinced that the decision of the Tax Court is correct. Accordingly, we affirm on the basis of the opinion of the Tax Court.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS,
EIGHTH CIRCUIT

UNITED STATES COURT OF APPEALS

For the Eighth Circuit

No. 80-1448

September Term, 1979

JAMES ISKE,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee,

Appeal from the United States Tax Court

Appellant's motion for a stay of the judgment rendered by the Tax Court, having been considered by the Court, is hereby denied.

August 22, 1980

CONSTITUTIONAL PROVISION

Amendment Article V . . . nor be deprived of life, liberty, or property without due process of law; . . .

No. 80-1364

MAR 25 1981
ALEXANDER L. STEVAS
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1980

JAMES ISKE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In the Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-1364

JAMES ISKE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The principal questions presented in this federal income tax case are whether the Commissioner properly determined the amount of capital gain that petitioner was required to recognize on the sale of easements across his property, whether certain legal expenses incurred by petitioner in connection with this award were adjustments to basis rather than deductions against ordinary income, and whether petitioner's sales of dirt, sand and gravel gave rise to ordinary income subject to depletion rather than capital gains.

The pertinent facts may be summarized as follows: In 1967, the Omaha Public Power District (OPPD) instituted two eminent domain proceedings in the Nebraska state courts to acquire right-of-way easements across two tracts of land owned by petitioner. The easements burdened only a small portion of each tract. Petitioner was ultimately

awarded $185,000 in damages and legal fees, plus interest (Pet. App. 3, 5).[1] On audit, the Commissioner of Internal Revenue determined that petitioner should report capital gain on these sales to the extent that the amounts received exceeded his basis in those portions of the tracts actually burdened by the easement. The Commissioner rejected petitioner's claims that he had no gain because the condemnation awards did not exceed his total basis in the tracts, and that the interest on the condemnation proceeds was exempt from taxation as interest on obligations of a state or its political subdivisions under Section 103 of the Internal Revenue Code of 1954 (26 U.S.C.).

In 1970 petitioner granted Hartford Sand and Gravel Company (Hartford) an option to purchase up to 200,000 tons of various minerals from his land at a fixed price per ton. No minimum purchases were required, and the agreement was to terminate on June 1, 1971. On audit, the Commissioner determined that the sales gave rise to ordinary income subject to depletion allowances, and not capital gains (Pet. App. 7-8).

In this proceeding brought by petitioner in the Tax Court for redetermination of the ensuing deficiency, the Tax Court upheld the Commissioner's determinations in every respect (Pet. App. 1-19). The court of appeals affirmed on the basis of the Tax Court's opinion (Pet. App. 20-21).

1. Petitioner argues (Pet. 3-4, 6) that gain on the sale of the easements should be recognized only to the extent the amount realized exceeds his basis in the tracts of land, despite the fact that the easements burdened only a small portion of those tracts. Treasury Regulations on Income Tax (1954 Code), Section 1.61-6(a) (26 C.F.R.), provides,

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[1]See *Iske* v. *Omaha Public Power District*, 185 Neb. 724, 178 N.W. 2d 633 (1970), for proceedings relating to the larger tract condemned.

however, that where part of a taxpayer's property is sold, only that portion of the taxpayer's basis actually allocable to the portion sold, rather than his basis in the entire property, is relevant for determining gain or loss.

The granting of an easement is such a partial sale. Accordingly, the decision below correctly held that petitioner had to recognize gain to the extent the amount realized on the sale exceeded that portion of his basis that was allocable to the property actually burdened by the easement. Cf. *Byram* v. *Commissioner*, 555 F. 2d 1234 (5th Cir. 1977); *Fasken* v. *Commissioner*, 71 T.C. 650 (1979).

Petitioner cites (Pet. 6) I.T. 2621, XI-1 Cum. Bull. 67 (1932), for the proposition that he need recognize no gain until the amount realized exceeds his basis in the entire property. That ruling, without mention of possible allocation, computed gain on the sale of an easement as the amount by which the sales proceeds exceeded taxpayer's basis in the entire tract.

But I.T. 2621 is no longer authoritative because it was declared obsolete in 1968 in Rev. Rul. 68-661, 1968-2 Cum. Bull. 607. Although the revocation was not explicitly made retroactive, the ground for the revocation was that the ruling was no longer viable in light of the 1954 Code and the Regulations issued thereunder. Furthermore, I.T. 2621 is also inconsistent with later authority, including *Blum* v. *Commissioner*, 5 T.C. 702 (1945); *Inaja Land Co.* v. *Commissioner*, 9 T.C. 727 (1947); Rev. Rul. 54-575, 1954-2 Cum. Bull. 145, and Rev. Rul. 59-121, 1959-1 Cum. Bull. 212, and was thus of doubtful validity long before its revocation in 1968. At all events, notwithstanding his claim to the contrary (Pet. 6), petitioner has failed to show that he

was subject to treatment that was not imposed upon other similarly-situated taxpayers.[2]

Petitioner further argues (Pet. 7) that a portion of the legal expenses he incurred during the condemnation proceedings should be deductible as an ordinary and necessary expense. But it is well settled that legal expenses incurred in defending title to property or in establishing the right to a higher condemnation award are capital in nature. *Madden* v. *Commissioner*, 514 F. 2d 1149 (9th Cir. 1975); *Casalina Corp.* v. *Commissioner*, 60 T.C. 694 (1973), aff'd per curiam, 511 F. 2d 1162 (4th Cir. 1975); Treasury Regulations on Income Tax (1954 Code), Section 1.212-1(k) (26 C.F.R.). Petitioner now argues for the first time that a portion of the legal expenses was incurred in establishing his right to the interest on the increased award. Apart from the fact that he never raised this argument below, it has no merit. The judicial proceedings were not to establish petitioner's right to interest, which accrues as a matter of statute (Neb. Rev. Stat. § 76-711 (Supp. 1980)) if the amount awarded exceeds the amount deposited in the county court by the condemnor. To the contrary, the judicial proceeding was to establish petitioner's right to additional condemnation proceeds.

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[2]Petitioner further argues (Pet. 6-7) that the courts below erred in not treating the $25,000 released to him by the county court in 1968 as income received in that year. But petitioner failed to raise this argument in either the Tax Court or the court of appeals. It is not properly before this Court.

At all events, petitioner failed to show that the award exceeded his basis in the property at that time. Petitioner's basis in that tract was $7,315, plus whatever portion of the $50,000 in legal and witness fees that had been incurred prior to the release of the $25,000 (Pet. App. 3, 6). The record is silent as to what these amounts were. Petitioner was reimbursed for some of those expenses in 1970 (Pet. App. 3).

2. Petitioner also contends (Pet. 7) that interest received pursuant to the condemnation proceedings should be excluded from gross income under Section 103 of the Internal Revenue Code, which excludes from gross income the interest on certain state and municipal obligations. That provision, like its predecessors, was passed to enhance the ability of state and local government to compete in the capital markets. Accordingly, it is well established that it applies only to "obligations" incurred under the governmental borrowing power, not to interest paid pursuant to operation of law. *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934). Thus, interest payments made pursuant to the condemnation power, not pursuant to the borrowing power, are not payments of interest on "obligations" within the meaning of Section 103, and are not exempt under that Section. *Drew* v. *United States*, 551 F. 2d 85 (5th Cir. 1977); *American National Bank of Austin* v. *United States*, 421 F. 2d 442 (5th Cir. 1970); *Holley* v. *United States*, 124 F. 2d 909 (6th Cir. 1942); *United States Trust Co. of New York* v. *Anderson*, 65 F. 2d 575 (2d Cir. 1933); *Fox* v. *United States*, 397 F. 2d 119 (8th Cir. 1968); *Williams Land Co.* v. *United States*, 31 F. Supp. 154 (Ct. Cl. 1940).

3. Finally, petitioner contends (Pet. 7) that amounts he received, pursuant to an agreement with a contractor whereby the contractor received the right to extract up to 200,000 tons of minerals at a fixed price for a limited time, were taxable as capital gain rather than ordinary income.

Normally, production income is taxable as ordinary income to the owner of a mineral deposit, who can then recoup his capital investment through the depletion allowance authorized by Section 611 of the Internal Revenue Code of 1954, *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308, 312 (1956); *Paragon Coal Co.* v. *Commissioner*,

380 U.S. 624, 626 (1965). Petitioner is the owner of the mineral deposits in question because he retained an "economic interest" in those deposits under the test first enunciated by this Court in *Palmer* v. *Bender*, 287 U.S. 551 (1933), and set forth in Section 1.611-1(b)(1) of the current Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.). Under this test, a taxpayer has a depletable "economic interest" if he has made an initial capital investment in the minerals in place, and has a continuing dependence on production income for a return of his capital.

The transfer of operating rights, without more, does not terminate the transferor's "economic interest" in the minerals in place (and hence is not a capital transaction), whether the transfer is made in consideration of payments dependent upon extraction or paid in a lump sum. See, *e.g.*, *Helvering* v. *Twin Bell Syndicate*, 293 U.S. 312 (1934); *Burnet* v. *Harmel*, 287 U.S. 103 (1932); *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U.S. 25 (1946). Thus, royalties in a fixed amount per unit of minerals removed are ordinary income, not capital gains, to a transferor of operating rights. *Bankers Coal Co.* v. *Burnet*, 287 U.S. 308 (1932). See also *Rabiner* v. *Bacon*, 373 F. 2d 537 (8th Cir. 1967); *Hartman Tobacco Co.* v. *United States*, 471 F. 2d 1327 (2d Cir. 1973); *Laudenslager* v. *Commissioner*, 305 F. 2d 686 (3d Cir. 1962), cert. denied, 371 U.S. 947 (1963); *Oliver* v. *United States*, 408 F. 2d 769 (4th Cir. 1969); *Wood* v. *United States*, 377 F. 2d 300 (5th Cir.), cert. denied, 389 U.S. 977 (1967); *Gitzinger* v. *United States*, 404 F. 2d 191 (6th Cir. 1968); *Freund* v. *United States*, 367 F. 2d 776 (7th Cir. 1966); *Alkire* v. *Riddell*, 397 F. 2d 779 (9th Cir. 1968); *United States* v. *White*, 401 F. 2d 610 (10th Cir. 1968). But cf. *Linehan* v. *Commissioner*, 297 F. 2d 276 (1st Cir. 1961).

Here, petitioner retained his interest in the minerals in place. Hartford had no obligation to purchase any minimum amount of minerals and merely paid a fixed price per ton for those minerals it chose to extract during the term of the contract. It is therefore plain that the royalties petitioner received were taxable as ordinary income and not capital gain.[3]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

MARCH 1981

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[3]Petitioner also challenges (Pet. 7) the court of appeals' denial of a stay pending his appeal. That action was fully in accord with Section 7485 of the Internal Revenue Code, which provides that assessment or collection of the deficiency determined by the Tax Court shall be stayed only if the taxpayer files a timely bond, and petitioner filed no such bond.

Moreover, this Court has repeatedly rejected petitioner's argument (Pet. 8) that he was denied due process because he was required to carry the burden of proof. See, *e.g.*, *Welch* v. *Helvering*, 290 U.S. 111, 115 (1933); *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440 (1934). See also Rules of Practice and Procedure of the United States Tax Court (Jan. 1, 1974), Rule 142(a).